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OFFICE OF THE
CITY AUDITOR

A CONTROLS REVIEW OF THE CITY'S CHECKWRITER SYSTEM

A REPORT TO THE
SAN JOSE
CITY COUNCIL
FINANCE COMMITTEE

87-01

CITY OF SAN JOSÉ, CALIFORNIA

151 W. MISSION STREET, ROOM 109
SAN JOSE, CALIFORNIA 95110
(408) 277-4601

GERALD A. SILVA
City Auditor

July 27, 1987

Honorable Mayor and Members
of the City Council
801 North First Street, Room 600
San Jose, CA 95110

Transmitted herewith is a report on *A Controls Review of the City's Checkwriter System.* This report is in accordance with City Charter Section 805(a).

An Executive Summary is presented on the blue papers in the front of this report while three Administration responses are shown on the yellow pages before the Appendices.

I will present this report to the Finance Committee at its August 5, 1987 meeting. If you need additional information in the interim, please let me know. The City Auditor staff who participated in the preparation of this report is Charles Christensen.

Respectfully submitted,

Gerald A. Silva
City Auditor

GS:mlt
EXSUM044

cc: Gerald E. Newfarmer, City Manager
Les White, Assistant City Manager
Susan George, Deputy City Manager
Edward G. Schilling, Director of Finance
James Daniels, Director of General Services
Tim Wei, Director of Information Systems
Emily Harrison, Chief of Accounting
Joan Gallo, City Attorney

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EXECUTIVE SUMMARY

In accordance with the City Auditor's approved 1985-86 Workplan, we have completed a review of the controls over the City's Checkwriter system. The City of San Jose makes its expenditures through two systems--Payroll and Accounts Payable. Although the Payroll System disburses the greater amount of money, the amount disbursed by the Accounts Payable System is significant. The Checkwriter is the computer system that assembles and prints the information on the City's vendor checks. During the first eight months of the current fiscal year, the Accounts Payable System generated over 26,000 machine-printed checks with a value exceeding $140 million.

Our original audit objective was to review the controls over the Checkwriter. However, during our review, we noted situations of audit interest beyond the Checkwriter. Accordingly, we expanded the scope of this audit to include the original audit objective of reviewing controls over the Checkwriter's generation of checks and those additional control issues noted during our review. The results of our audit are:

- Checkwriter controls need improvement.
- The entire Accounts Payable System needs to be documented and reviewed for controls and efficiency.
- Labor error suspense accounts need supervision.

Controls on Checkwriter Need Improvement

The Checkwriter is the portion of the Accounts Payable System which 1) organizes the computer records of individual payment authorizations, 2) adds the vendor reference information to the computer records and 3) prints checks for vendors. The Finance Department, as the owner of this computer system, has responsibility for its operation and control. The Information Systems Department constructs (and modifies) computer programs to meet Finance Department specifications, and performs the resulting computer processings. Our review disclosed that certain controls over the Checkwriter are missing entirely, incomplete, or not performed at the most effective time. Our review revealed the following control weakness in the Checkwriter process.

- Accounts payable input batches are not approved.
- Record counts but not dollar values are used to control the creation of checks.
- Additional controls are needed over the vendor master.
- Reviews of computer reports from the Checkwriter are not adequate.
- Additional controls are needed over the use of check stock.
- Information Systems initiated Checkwriter System modifications without obtaining written authorization from the Accounts Payable Section.

The Entire Accounts Payable System Needs To Be Documentated and Reviewed for Controls and Efficiency

The numerous functions which comprise the Accounts Payable processes of initiating, authorizing, and making payments to vendors are accomplished by the coordinated efforts of numerous organizational units of the City. All departments/offices initiate payments to vendors. These same organizations or the centralized purchasing unit of General Services perform the authorizing process, subject to Finance Department checks against appropriation limits. Making payments involves the departments/offices, the centralized purchasing/receiving units of General Services, the centralized accounts payable unit of the Finance Department, and the centralized computer processing of the Information Systems Department. Our review revealed the following control weaknesses in the Accounts Payable processes that precede and follow the Checkwriter.

- Accounts Payable and originating departments distribute signed checks.
- General Ledger Section and the Finance Director's support staff do not have desk instructions for their payables functions.
- Authorizing documents for major disbursements are cancelled before checks are manually signed.
- Original Confirming Purchase Orders are not used as payment authorizing documents and are eventually thrown away.

- The process for preparing and handling the annual 1099 information returns for vendors is inadequate.
- Accounts Payable system documentation is inadequate.

Labor Error Suspense Accounts Need Supervision

During our review of the Checkwriter, we found that all the charges we reviewed in the labor error suspense accounts were appropriately originated in the Payroll System. However, we also noted that some charges remained uncorrected for many months and some charges were corrected twice, resulting in double charging of some labor charges.

RECOMMENDATIONS

In order to provide controls over the Checkwriter, Accounts Payable System, and labor error suspense accounts, we recommend that:

Recommendation #1:

The Senior Accountant who is the Supervisor of the Accounts Payable Section should review all matched document sets in each batch for proper approval and determine that the batch totals on the transmittal are correct. This review should be evidenced by the reviewer's initials on the batch transmittal.

In addition, the reviewer should deliver approved batches to the General Ledger Section where batches should be checked for approval before the batches are logged and forwarded to the Data Entry Section of Information Systems. (Priority 2)

Recommendation #2:

Information Systems use the accumulated dollar value of the accounts payable input file as well as the record count as a means of controlling the accuracy of the file of checks to be printed. (Priority 3)

Recommendation #3:

Accounts Payable establish an appropriate scheme of control over the Vendor Master File beyond the current access restriction by password. (Priority 2)

Recommendation #4:

Someone other than any person who maintains the Vendor Master File should compare the payee on the signed check to the name on the payment authorization document and also compare the address. This task should preferably be done by someone wholly outside the Accounts Payable Section. (Priority 2)

Recommendation #5:

Finance Department management use the GADW20 "Audit Check of Vendors in File" to control the manual review of payees per the payment authorizations to the payees on the signed checks. The report can also be used to monitor the frequency and cause of any discrepancies in payee names. (Priority 2)

Recommendation #6:

Absent the satisfactory implementation of recommendations #3, #4, and #5, the Finance Department should review endorsements on cancelled checks during the bank reconciliation process. (Priority 2)

Recommendation #7:

The General Ledger Section spot check some source documents for approvals, agreement to the computer reports, and agreement to an actual check. These tasks should be completed before the payment authorization documents, computer reports, and signed checks are released for distribution. The Accounts Payable Section should also review the computer reports from the Checkwriter. (Priority 2)

Recommendation #8:

The Finance Director's office reconcile its check use log to the log of check stock removed from the locked storage area to determine that all the stock removed has been used for authorized purposes. This reconciliation should be made at least weekly. (Priority 2)

Recommendation #9:

The Director of Finance should designate someone other than the preparer of the check use log to periodically review reconciliations of the check use log to the check stock log. The reviewer should evidence his or her review by initialling and dating the reconciliations. (Priority 2)

Recommendation #10:

Information Systems only undertake modifications to the accounts payable computer processes after obtaining written approval from the Accounts Payable Section Supervisor. Also, Information Systems should provide training to the current Accounts Payable Section staff regarding the features and operation of all computer systems related to Accounts Payable. (Priority 2)

Recommendation #11:

Finance Department should either discontinue the practice of giving signed checks to Accounts Payable Section and the requesting department, or institute additional controls to mitigate the risks that are inherent in the practice. (Priority 2)

Recommendation #12:

Finance Department finalize and issue desk instructions on accounts payable functions for the General Ledger Section and the Finance Director's office. In addition, the desk instructions for the Accounts Payable Section should be amended to incorporate the recommendations in this report. (Priority 2)

Recommendation #13:

Finance Department require that the second signer on large checks review for appropriateness the date perforated into the supporting payment authorization documents, and evidence this review by writing that date and their initials next to the perforated date. (Priority 2)

Recommendation #14:

Purchasing change the instructions for Confirming Purchase Orders so that the preparing departments forward the original to Purchasing and a copy to Accounts Payable. (Priority 3)

Recommendation #15:

An Accounting Division supervisory employee not within the Accounts Payable Section review the production and mailing of 1099's and the handling of vendor inquiries or 1099's returned as undeliverable by the Post Office. (Priority 2)

Recommendation #16:

Finance Department make a thorough review of all the current requirements for filing 1099 annual information returns for vendor payments. (Priority 2)

Recommendation #17:

Finance Department document the Accounts Payable System completely, and then review that documentation for controls and efficiency. (Priority 2)

Recommendation #18:

Accounts Payable Section should log vendor invoices received and forwarded to departments for processing. Accounts Payable should follow-up on the timely return of such invoices for payment. (Priority 3)

Recommendation #19:

Finance Department assign someone to monitor the balances of the labor error suspense accounts and follow-up with the organizations from which those charges originated. (Priority 2)

BACKGROUND

The City of San Jose makes its expenditures through two systems--Payroll and Accounts Payable. Although the Payroll System disburses the greater amount of money, the amount disbursed by the Accounts Payable System is significant. The Checkwriter is the computer system that assembles and prints the information on the City's vendor checks. During the first eight months of the current fiscal year, the Accounts Payable System generated over 26,000 machine-printed checks with a value exceeding $140 million. The average value of a machine-printed check during that period was over $5,300. During that same period, the Accounts Payable System was used to record an additional 300 manual checks with a total value of almost $44 million and an average value per check of $148,000. Thus, the Accounts Payable System records an estimated $275 million in checks each year of which the Checkwriter system machine prints about 39,000 checks valued at $210 million.

The computer portions of the Accounts Payable System are part of the City's General Accounting System. That accounting system is based on a batch mode of processing with input being accumulated during the day and the computer processings being run during the night shifts. That system is the basic Accounts Payable System today. An on-line Vendor Master System and a Checkwriter System were added to enhance the Accounts Payable System.

The on-line Vendor Master System was added in 1982 to facilitate inquiry and additions to the vendor master during the regular day shift. However, this on-line vendor master facility actually accumulates each day's input for overnight updating of the Vendor Master File in the General Accounting System.

The Checkwriter System was implemented in 1986. It is a batch mode system that added the capability to put multiple payments for a single vendor on a single check. In order to inform the vendor of what is being paid, the Checkwriter takes in additional information in the form of the vendor's reference number for each of the amounts being paid. The vendor reference numbers, together with the related amounts, are printed on the remittance advice portion of the check form when the Checkwriter prints the checks. This reference information, along with the pre-assigned check number used, is later transferred into the Accounts Payable System so that it appears on the reports from that system, too. The Accounts Payable System is still run in its entirety except that checks are no longer printed by it. Thus, the Checkwriter is a parallel (and duplicate) operation to a portion of the Accounts Payable System. In addition, the Checkwriter creates a history file of check data which can be accessed through on-line inquiry.

AUDIT SCOPE

Initially, our audit scope was to review the controls over the Checkwriter which now produces the machine-printed accounts payable checks. The audit scope was purposely limited with the intention of quickly reviewing this specific computer processing.

The preliminary survey phase of this review revealed situations of audit interest beyond the Checkwriter. In order to surface the control issues raised in the preliminary survey without delay, the scope of this review was kept to the minimum necessary to meet the original audit objective of controls on the Checkwriter's generation of checks, plus clarification of those additional control issues surfaced in the preliminary review.

This report deals with the Checkwriter controls in FINDING I. Additional Accounts Payable System matters noted during this review are included in FINDING II. One matter was noted which is outside the Accounts Payable System, and it is reported as FINDING III.

FINDING I

CONTROLS ON CHECKWRITER NEED IMPROVEMENT

The Checkwriter is the portion of the Accounts Payable System which 1) organizes the computer records of individual payment authorizations, 2) adds vendor reference information to the computer records and 3) prints checks for vendors. The Finance Department, as the owner of this computer system, has responsibility for its operation and control. The Information Systems Department constructs (and modifies) computer programs to meet Finance Department specifications, and performs the resulting computer processings. Our review disclosed that certain controls over the Checkwriter are missing entirely, incomplete, or not performed at the most effective time.

- Accounts Payable input batches are not approved.
- Record counts but not dollar values are used to control the creation of checks.
- Additional controls are needed over the vendor master.
- Reviews of computer reports from the Checkwriter are not adequate.
- Additional controls are needed over the use of check stock.
- Information Systems initiated Checkwriter System modifications without obtaining written authorization from the Accounts Payable Section.

ACCOUNTS PAYABLE INPUT BATCHES ARE NOT APPROVED

The Senior Accountant who supervises the Accounts Payable Section reviews every individual payment authorization. This review is evidenced by that accountant's initials entered in an approval box provided on each authorization form for this purpose. The approved individual payment authorizations are then returned to the accounts payable processing staff for assembly into batches and preparation of the batch transmittal sheet which controls the batch by listing the total items count and total dollar value. The accounts payable processing staff delivers the batches, together with the batch transmittals, to the General Ledger Section for logging and delivery to the computer Data Entry Section of Information Systems.

This sequence of tasks results in individual payment authorizations not being under batch control when they are approved. Consequently, there is a risk that lost/misplaced individual authorizations would not be detected. It also results in batch control transmittals not being reviewed or approved--although a "Checked By" box is provided on the transmittal form.

Controls over this process can be improved by having the Supervisor of the Accounts Payable Section review all matched document sets in each batch for proper approval and determine that the batch totals on the transmittal are correct. Further, the review of the whole batch and the accuracy of the batch transmittal should be evidenced by the reviewer's initials on the batch transmittal. Finally, the reviewed batches should not be returned to the accounts payable processing clerks. Instead, the reviewer should deliver the reviewed batches directly to the General Ledger Section where the batch approval is noted before any batches are logged and forwarded directly to the Data Entry Section of Information Systems.

RECORD COUNTS BUT NOT DOLLAR VALUES ARE USED TO CONTROL CREATION OF CHECKS

As the payment authorization batches are converted to a computer machine-readable file, the Data Control Section of Information Systems logs the accumulated record count of each week's file of items to be paid, but does not accumulate the dollar value of that file.

Since payments are the objective of the Accounts Payable process, the use of the accumulated dollar amount of accepted input (as well as the accumulated record count) would give a better indication of whether the computer processing is proceeding as intended. It might be useful for General Ledger to supply Data Control with the dollar total for the week per their input log. Assuring the accuracy of the Checks File at the time it is created from the payment authorizations file is significant because it reduces the risk that computer time and check stock could be wasted as a result of a misprocessing.

ADDITIONAL CONTROLS ARE NEEDED OVER THE VENDOR MASTER

The Vendor Master File, not the payment authorization documents, is the source of the payee names and addresses printed onto checks. Information Systems key-enters the vendor number and payee name per the payment authorization documents to the computer machine-readable records of those documents. The Checkwriter uses the vendor number to determine the name and address from the Vendor Master File which will be used as the check's payee name and address. In this way, the vendor number controls the payee name and mailing address for checks. The Checkwriter produces a report showing the payee name that was key-entered from the payment authorization document with the payee name put onto the check printed next to it.

Inadequate Controls Over Vendor Master File

There are no controls on the Vendor Master File beyond the access restriction by password. That password is known by only two of the accounts payable processing clerks, and they make all additions, changes, and deletions from the Vendor Master File. Special Payment Demands or memos from the Purchasing Division are used to initiate changes to the Vendor Master. The Vendor Master System produces a report listing the change activity, but it is only the clerks who made the changes who review it. The changes in the number of Vendor Master records is not reviewed nor is the total number of records (currently over 24,000) tracked. The result is there is no management control or monitoring of the Vendor Master File which determines the payee name and mailing address printed onto the check. There are many standard Vendor Master File control techniques from which Accounts Payable should select an appropriate combination. Such control techniques include but are not limited to:

- Management review and approval of reports showing Vendor Master records before and after changes, and
- Periodic balancing and reconciliation of the total number of Vendor Master records in the files by a person who has no responsibilities for initiating or processing changes to those files.

Payee Names on Checks But Not Addresses Are Compared to Source Documents

A control exists on the accuracy of the payee name printed on the checks. After the signed checks are received by the Accounts Payable Section, the accounts payable processing clerks compare the payee name per the payment authorization document to the payee name printed on the signed check. However, the remittance address is not compared even though it appears below the payee name on both the payment authorization and the check. The address is critical in getting the payment to the proper destination because most checks are mailed. Given the current lack of controls over the source of payee addresses (the Vendor Master File), a final check for address accuracy seems appropriate. This final check should be performed by someone other than the accounts payable processing clerks who maintain the Vendor Master File. In fact, it would be preferable if a staff member wholly outside the Accounts Payable Section performed the final check.

No Review of Report Comparing Payee Name Per Check to Payee Name per Payment Authorizing Document

The Checkwriter computer system generates a report which compares the payee name as key-entered from the payment authorization document with the payee name on the resultant check. This report is titled "Audit Check of Vendors In File." Currently, this report is only put into a binder and is not reviewed by anyone. Management could use this report as a check on the manual comparison previously described and to monitor the frequency and cause of any discrepancies in payee names between the payment authorizations and the checks.

No Review of Vendor Endorsements on Paid Checks

We inquired about the possible review of endorsements on cancelled checks. A review of endorsements is a control which increases assurance that the proper payee actually received the check. We were told that no review of check endorsements is made other than the review of samples by auditors. Since the

Finance Department does not control either the scope or timing of the auditors' work, the auditors' reviews should not be considered as a substitute for a Finance Department review. The Department could review check endorsements as part of its bank reconciliation procedure.

REVIEWS OF COMPUTER REPORTS FROM THE CHECKWRITER ARE NOT ADEQUATE

The General Ledger Section receives the signed checks and Checkwriter computer reports directly from Information Systems. After agreeing the record counts and dollar totals per the input log and per the computer reports, General Ledger releases to Accounts Payable, the signed checks, computer reports, and all input authorization documents. The ideal time to review these materials for compliance, consistency, and reasonableness is when the General Ledger Section has all of these materials in its possession. Spot checks of some source documents for approvals, agreement to the computer reports, and agreement to an actual check would provide additional assurance that payments are being processed accurately.

During the course of our review, we did not see any indication that the Accounts Payable Section performs any regular reviews of the Checkwriter reports.

ADDITIONAL CONTROLS ARE NEEDED OVER THE USE OF CHECK STOCK

During our review, we found three major logs that account for the prenumbered check stock:

1. A log which shows the prenumbered check forms issued and those returned to the locked storage area. This log is kept by the General Ledger Section person who issues the check stock from the locked storage area.
2. A log which shows the numerical sequences of the prenumbered check stock actually used (per the person responsible for observing the machine signing) plus General Ledger's reports of manual checks issued. The Finance Director's office keeps this log.
3. An informal log to assist in preparing "Bank Transmittal Letters" which advise the bank of checks issued or cancelled. The General Ledger Section keeps this log.

Check Stock Usage Log is Not Related to Withdrawals from Check Stock Storeroom

The above check stock logs notwithstanding, currently there is not a timely, direct control to assure that check stock taken from the storage area is used for authorized purposes. Such a control could be accomplished if the logs described in items 1 and 2 above were reconciled. This reconciliation should be done at least weekly so that any discrepancies are noted on a reasonably timely basis.

Sequence Gap in Check Stock Usage Log Not Followed-Up

Our review of the check use log, maintained by the Finance Director's office (item 2 above), revealed a gap in the sequential accounting for check numbers. Detection of such gaps is the primary purpose of this log. This gap occurred for three checks in the March 20 through March 23 period. Apparently, this condition had been noted as a few lines were left blank between the previous usage entry and the subsequent usage entries. However, no follow-up had occurred until our May 4 discovery of this gap. This failure may have been caused by a mid-April change in the person assigned to keep the log or by the lack of written instructions (see FINDING II) on maintaining the log. While this instance did serve to remind the current log maintainer of the necessity to account for the sequential use of the checks, it also points out the need for someone other than the preparer of the check use log to periodically review the reconciliations of the check use log to the withdrawals per the check forms storeroom log to assure that this critical control has actually been accomplished. This periodic review to assure that the sequence of the check numbers has actually been accounted for should be evidenced by the reviewer initialling and dating the reconciliations.

INFORMATION SYSTEMS INITIATED CHECKWRITER SYSTEM MODIFICATIONS WITHOUT OBTAINING WRITTEN AUTHORIZATION FROM THE ACCOUNTS PAYABLE SECTION

During the period of our review, a mistake was made in the Checkwriter processing which necessitated destruction of the first printing of checks and the rerunning of the Checkwriter. Subsequently, Information Systems undertook modifications of the Checkwriter's computer programs to reduce or detect future instances of such mistakes. After learning of these ongoing modifications, we mentioned them to the Accounts Payable Section supervisory staff who stated that they did not know of any modifications. The modifications Information Systems under-took appear to be appropriate and relatively minor. However, the failure to obtain a written authorization prior to initiating the modifications is a serious breach of controls. The integrity of all computer systems is based on the principle of prior authorization and no breach of it should occur. The only possible exception to this principle would be in cases of recovery from a catastrophic event. It should be noted that staff in the Accounts Payable Section are not familiar with their own systems. Therefore, Information Systems should provide training to the current staff so that they may better understand the operation of the computer systems and the implications of proposed system changes.

CONCLUSION

The controls over the Checkwriter need improvement. Accounts Payable needs to 1) approve batch transmittals for payment input authorization batches and 2) have the approver of the batch transmittals deliver those approved batches directly to the General Ledger Section. In addition, Information Systems could improve control over the machine-readable file of payment authorizations and the checks that are generated from that file by establishing an accumulated total of the dollar amount of the payment authorization file as well as the currently used record count. Further, Accounts Payable can establish additional controls on the Vendor Master File which is the source of the payee name and mailing address on checks. Moreover, reviewing mailing addresses and the computer report which lists both the payee printed on the payment authorization and the payee printed on the check would strengthen that review process. Additionally, the General Ledger Section can help assure that payments are reaching the intended vendor by comparing the endorsements on paid checks to the payee names on the checks. In addition, the Finance Department can better assure that blank checks are only used for authorized purposes by reconciling the usage log to the checks taken from the locked storage area per the blank check inventory log. Further, Finance could assign a reviewer to review and approve those reconciliations. Finally, Information Systems should not undertake any computer system modifications unless the owner of the system has given prior written authorization.

RECOMMENDATIONS

In order to provide controls over the Checkwriter, we recommend that:

Recommendation #1:

The Senior Accountant who is the Supervisor of the Accounts Payable Section should review all matched document sets in each batch for proper approval and determine that the batch totals on the transmittal are correct. This review should be evidenced by the reviewer's initials on the batch transmittal. In addition, the reviewer should deliver approved batches to the General Ledger Section where batches should be checked for approval before the batches are logged and forwarded to the Data Entry Section of Information Systems. (Priority 2)

Recommendation #2:

Information Systems use the accumulated dollar value of the accounts payable input file as well as the record count as a means of controlling the accuracy of the file of checks to be printed. (Priority 3)

Recommendation #3:

Accounts Payable establish an appropriate scheme of control over the Vendor Master File beyond the current access restriction by password. (Priority 2)

Recommendation #4:

Someone other than any person who maintains the Vendor Master File should compare the payee on the signed check to the name on the payment authorization document and also compare the address. This task should preferably be done by someone wholly outside the Accounts Payable Section. (Priority 2)

Recommendation #5:

Finance Department management use the GADW20 "Audit Check of Vendors in File" to control the manual review of payees per the payment authorizations to the payees on the signed checks. The report can also be used to monitor the frequency and cause of any discrepancies in payee names. (Priority 2)

Recommendation #6:

Absent the satisfactory implementation of recommendations #3, #4, and #5, the Finance Department should review endorsements on cancelled checks during the bank reconciliation process. (Priority 2)

Recommendation #7:

The General Ledger Section spot check some source documents for approvals, agreement to the computer reports, and agreement to an actual check. These tasks should be completed before the payment authorization documents, computer reports, and signed checks are released for distribution. The Accounts Payable Section should also review the computer reports from the Checkwriter. (Priority 2)

Recommendation #8:

The Finance Director's office reconcile its check use log to the log of check stock removed from the locked storage area to determine that all the stock removed has been used for authorized purposes. This reconciliation should be made at least weekly. (Priority 2)

Recommendation #9:

The Director of Finance should designate someone other than the preparer of the check use log to periodically review the reconciliations of the check use log to the check stock log. The reviewer should evidence his or her review by initialling and dating the reconciliations. (Priority 2)

Recommendation #10:

Information Systems only undertake modifications to the accounts payable computer processes after obtaining written approval from the Accounts Payable Section Supervisor. Also, Information Systems should provide training to the current Accounts Payable Section staff regarding the features and operation of all computer systems related to Accounts Payable. (Priority 2)

FINDING II

THE ENTIRE ACCOUNTS PAYABLE SYSTEM NEEDS TO BE DOCUMENTED AND REVIEWED FOR CONTROLS AND EFFICIENCY

The numerous functions which comprise the Accounts Payable processes of initiating, authorizing, and making payments to vendors are accomplished by the coordinated efforts of numerous organizational units of the City. All departments/offices initiate payments to vendors. These same organizations or the centralized purchasing unit of General Services perform the authorizing process, subject to Finance Department checks against appropriation limits. Making payments involves the departments/offices, the centralized purchasing/receiving units of General Services, the centralized accounts payable unit of the Finance Department, and the centralized computer processing of the Information Systems Department. Our review revealed the following control weaknesses in the Accounts Payable processes that precede and follow the Checkwriter.

- Accounts Payable and originating departments distribute signed checks.
- General Ledger and the Finance Director's office do not have desk instructions for their payables functions.
- Authorizing documents for major disbursements are cancelled before checks are manually signed.

- Original Confirming Purchase Orders are not used as payment authorizing documents and are eventually thrown away.
- The process for preparing and handling the annual 1099 information returns for vendors is inadequate.
- Accounts Payable system documentation is inadequate.

The Accounts Payable Process

APPENDIX A consists of flowcharts showing the sequence of major Accounts Payable processing steps and the organizations that perform those steps. Because of the large number of individual transactions and the variance in their natures, each organization must understand its own duties and how those duties relate to the whole system. APPENDIX A demonstrates the numerous organizations and functions involved in vendor payments and why task assignments must be carefully designed to assure appropriate assignment and sequencing.

Because no overall representation of the City's accounts payable process exists, the City Auditor's Office pooled information and drafted a set of flowcharts for the process. Audit staff then requested the organizations who perform the processes depicted on the flowcharts to review them for completeness and accuracy. The flowcharts shown in APPENDIX A are the result of that effort and are correct as of June 1987.

A review of the whole Accounts Payable System depicted on the charts was clearly beyond the scope of this review of the Checkwriter controls. However, our review did bring out the following points which we felt should be addressed.

ACCOUNTS PAYABLE AND ORIGINATING DEPARTMENTS DISTRIBUTE SIGNED CHECKS

Accounts Payable receives signed checks and either distributes them or gives them to the requesting department for distribution. Checks are the equivalent of money which is an asset. Thus, the practice of Accounts Payable receiving signed checks is a violation of one of the most basic internal control principles. Specifically, the same person(s) should not have both custody of an asset and perform the duty of maintaining the records of that asset. Accounts Payable's possession of the signed checks directly violates the internal control principle that there be separation of the check preparation and the mailing of signed checks. Further, the practice of giving signed checks to the requesting department for distribution violates the internal control principle that persons authorizing a check request should not be given the signed check. Current procedures throughout the Accounts Payable System do not appear to contain any extraordinary controls to offset these violations of internal control principles. Signed checks should not be given to the Accounts Payable Section or the requesting department unless additional controls are in place to assure the propriety of check payments.

It should be noted that in 1985 the City Auditor discussed this situation with Finance representatives. At the time of that discussion, Finance wanted and received City Auditor agreement that an outside auditor recommendation to have Payroll Section staff distribute vendor checks and Accounts Payable Section staff distribute payroll checks was impractical. According to Finance, such an arrangement created processing problems (See APPENDIX B). Based upon our latest review, we feel that the current practice of giving signed accounts payable checks to either Accounts Payable or the requesting department exposes the City to risks that are not tolerable. Finance should either discontinue this practice or institute additional controls to sufficiently mitigate the risks that are inherent in the practice.

GENERAL LEDGER SECTION AND THE FINANCE DIRECTOR'S OFFICE DO NOT HAVE DESK INSTRUCTIONS

Desk instructions contain specific instructions for the work tasks to be performed at a specific work location. Desk instructions are used for training and maintaining the integrity of the work process. At the time of our review, Accounts Payable had drafted desk instructions for its own staff but had not issued those instructions. Since our review, desk instructions have been issued to the Accounts Payable Section staff. However, these recently issued Accounts Payable desk instructions should be amended to incorporate several of the recommendations in this report. No desk instructions exist for the accounts payable functions of the General Ledger Section and the Finance Director's office. Desk instructions need to be promulgated and issued for these two units outside of the Accounts Payable Section.

AUTHORIZING DOCUMENTS FOR MAJOR DISBURSEMENTS ARE CANCELLED BEFORE CHECKS ARE SIGNED

All payment authorizing documents are perforated by a machine which punches the word "PAID" and the payment date through all the documents. This procedure, coupled with the rule of only paying on originals of vendor invoices, is designed to prevent duplicate payments on the same documentation. This perforation occurs before the documents and those checks that are large enough to require a second signature, are submitted to the signer of the second signature. The second signer may be the only manual signer of a check when the Finance Director's signature plate is used for the first signature. The second signer is required to review the supporting documents before signing the check. As the perforations are not easily read and signers are accustomed to receiving documents already perforated, the review of the perforated date is critical in order to prevent multiple payments based on the same documentation. Accordingly, second check signers should be required to also review perforated dates, and evidence their review by entering that date and their initials next to the perforated date.

ORIGINAL CONFIRMING PURCHASE ORDERS ARE NOT USED AS AUTHORIZING DOCUMENTS AND ARE EVENTUALLY THROWN AWAY

Current procedures require departments to type confirming purchase orders, and distribute the original to Accounts Payable with a copy sent to Purchasing. Accounts Payable only uses the original as a temporary advice with which to match any vendor invoices received before a copy is received from Purchasing. After receiving the copy processed by Purchasing, Accounts Payable throws out the original. By requiring departments to send originals of Confirming Purchase Orders to Purchasing and copies to Accounts Payable, the following improvements should result:

- Purchasing would have the original, and most legible, version upon which to perform their authorization process.
- Accounts Payable would use the original (rather than a copy) received from Purchasing as the payment authorization. This would also eliminate the current procedure's violation of the general rule of not using copies as payment authorizations.

THE PROCESS FOR PREPARING ANNUAL 1099 INFORMATION RETURNS FOR VENDORS IS INADEQUATE

The City is required to supply the Internal Revenue Service (IRS) and the concerned vendor with annual reports on Form 1099. These forms show the totals of specified classes of payments made to vendors. In recent years, the IRS has concentrated on these reports resulting in an explosion of the criteria for the circumstances requiring that a 1099 be filed. In addition, numerous versions of the 1099 form have been developed to meet these diverse reporting criteria. The penalty amount for the failure to file 1099's has also been increased to a significant level.

Accounts Payable Prepares and Distributes Vendor 1099's

Accounts Payable controls all the City's annual vendors' 1099 processes. Accounts Payable sets the criteria for generating 1099's from the computer files, decides which 1099's will be mailed, and handles all inquiries and those 1099's returned by the Post Office. In our opinion, Accounts Payable's participation in developing the criteria for 1099 preparation is appropriate. However, an Accounting Division supervisory employee not within the Accounts Payable Section should review the production and mailing of 1099's, the handling of vendor inquiries, and those 1099's returned by the Post Office.

Required 1099's for Partnership Vendors Not Prepared

During our review, we noted that the criteria for 1099's for 1986 excluded any vendor whose tax identification number (TIN) was not a social security number. Since partnerships do not use a social security number for their TIN, this criteria excluded partnerships from the 1099 preparation. Yet the IRS specifically requires 1099's for partnerships. For example, 1099's are required for rents or professional fees paid to partnerships. As mentioned above, the circumstances requiring 1099's and the penalties for failure to file them have increased greatly in recent years. Use of the old criteria is no longer adequate to meet the new requirements. A thorough review should be made of all the current requirements for filing the various 1099 annual information returns of vendor payments.

ACCOUNTS PAYABLE SYSTEM DOCUMENTATION IS INADEQUATE

As discussed in the introductory paragraphs to this FINDING the numerous functions which comprise the accounts payable processes of initiating, authorizing, and making payments to vendors are accomplished by the coordinated efforts of numerous organizational units. The current lack of documentation for the complete process necessitated that audit staff prepare the system flowcharts in APPENDIX A. Finalization of those flowcharts, or complete documentation by another method, is still required. Such documentation would assist operating management to 1) understand the system, 2) provide a context for the training of existing and future staff members and 3) provide a context for proposed changes to the system. No comprehensive review has been made for the controls or efficiency of the current system configuration, even though there have been recent system and staff changes. Such a review cannot take place until the entire Accounts Payable System has been thoroughly documented.

The Appendix A chart on page A-1 illustrates the value of such a comprehensive review. Specifically, the chart shows that the Accounts Payable Section receives and forwards vendor invoices to departments without establishing any controls over those invoices. At best, this represents an inefficient practice, and at worst, a lost opportunity to properly control vendor invoices. Accordingly, in our opinion, the Accounts Payable Section should log those invoices forwarded to other departments and institute appropriate follow-up procedures.

CONCLUSION

Our review of the Checkwriter required us to review other aspects of the whole Accounts Payable System. Our review revealed that complete documentation does not exist for the current system. Accordingly, we prepared flowcharts (contained in APPENDIX A) to facilitate our audit. In order that operating management can understand the whole system, the set of flowcharts (or some other documentation method) needs to be finalized. After finalization, management will have the information necessary to review the Accounts Payable System for controls and efficiency. The APPENDIX A flowcharts assisted us in identifying Checkwriter control issues which were included in FINDING I of this report. In addition, we noted the following control weaknesses: Accounts Payable Section and initiating departments distribute signed checks, Accounts Payable, General Ledger and the Finance Director's office do not have desk instructions, authorizing documents for major disbursements are cancelled before checks are manually signed, original Confirming Purchase Orders are not used to support payment authorizations, the process for preparing annual 1099 information is inadequate.

RECOMMENDATIONS

In order to provide controls over the Accounts Payable System, we recommend that:

Recommendation #11:

Finance Department should either discontinue the practice of giving signed checks to Accounts Payable Section and the requesting department, or institute additional controls to mitigate the risks that are inherent in the practice. (Priority 2)

Recommendation #12:

Finance Department finalize and issue desk instructions on accounts payable functions for the General Ledger Section and the Finance Director's office. In addition, the desk instructions for the Accounts Payable Section should be amended to incorporate the recommendations in this report. (Priority 2)

Recommendation #13:

Finance Department require that the second signer on large checks review for appropriateness the date perforated into the supporting payment authorization documents, and evidence this review by writing that date and their initials next to the perforated date. (Priority 2)

Recommendation #14:

Purchasing change the instructions for Confirming Purchase Orders so that the preparing departments forward the original to Purchasing and a copy to Accounts Payable. (Priority 3)

Recommendation #15:

An Accounting Division supervisory employee not within the Accounts Payable Section review the production and mailing of 1099's and the handling of vendor inquiries or 1099's returned as undeliverable by the Post Office. (Priority 2)

Recommendation #16:

Finance Department make a thorough review of all the current requirements for filing 1099 annual information returns for vendor payments. (Priority 2)

Recommendation #17:

Finance Department document the Accounts Payable System completely, and then review that documentation for controls and efficiency. (Priority 2)

Recommendation #18:

Accounts Payable Section should log vendor invoices received and forwarded to departments for processing. Accounts Payable should follow-up on the timely return of such invoices for payment. (Priority 3)

FINDING III

LABOR ERROR SUSPENSE ACCOUNTS NEED SUPERVISION

During our review of the Checkwriter, we reviewed the Department Distribution Errors accounts for any accounts payable items. We found that all the charges we reviewed in these labor error suspense accounts were appropriately originated in the Payroll System. However, we also noted that some charges remained uncorrected for many months and some charges were corrected twice, resulting in double charging of some labor charges.

Every entry to an accounting system must be coded with a charge number. For various reasons, some entries are coded with charge numbers that do not agree with the current list of authorized charge numbers. Such charges originating from the Payroll System are charged to a series of labor error suspense accounts where they are temporarily carried. After determination of the appropriate authorized charge numbers, these charges are transferred out of the labor error suspense accounts and entered against authorized charge numbers.

No one in the Finance Department has been assigned to monitor labor error suspense accounts for reasonableness and timely correction of entries. Each originating organization receives computer listings of the new charges added to the labor error suspense accounts each time a payroll is run. In addition, every month Finance sends each originating organization a year-to-date listing of every transaction in their labor error suspense account. However, no one in the Finance Department monitors to see that originating organizations use this information to actually make subsequent corrections. Maintaining budgetary control of expenses and capital projects requires that charges be recorded against the budgetary authorizations and not left in a labor error suspense account. Double charging errors through over-correction also distorts the budgetary control process.

We also noted a case where charges were held in a labor error suspense account for most of the fiscal year because the unit benefiting from the work had not opened charge numbers against which to record those charges. By monitoring the labor error suspense accounts Finance could alert management to such situations and assure timely and accurate correction of suspense items.

RECOMMENDATION:

We recommend that:

Recommendation #19:

Finance Department assign someone to monitor the balances of the labor error suspense accounts, and follow-up with the organizations from which those charges originated. (Priority 2)

CITY OF SAN JOSE - MEMORANDUM

TO: Gerald Silva
City Auditor

FROM: Edward G. Schilling
Director of Finance

SUBJECT: RESPONSES TO CHECKWRITER AUDIT

DATE: July 21, 1987

APPROVED

DATE 7-23-87

Finance-Accounting has studied the Controls Review of the City's Checkwriter System, and would like to offer the following responses to the recommendations included in that report. Recommendations 2, 10, and 14 refer to Information Systems and General Services/Purchasing respectively, and are not addressed here, although Finance is in accord with the Auditor's findings.

It is appropriate as well to acknowledge the professional and helpful attitude evidenced by the City Auditor and his staff during the process of conducting this audit. Finance has found the discussion and recommendations very helpful in improving both the controls and processes associated with the accounts payable function.

RECOMMENDATION #1: The Senior Accountant who is the Supervisor of the Accounts Payable Section should review all matched document sets in each batch for proper approval and determine that the batch totals on the transmittal are correct. This review should be evidenced by the reviewer's initials on the batch transmittal. In addition, the reviewer should deliver approved batches to the General Ledger Section where batches should be checked for approval before the batches are logged and forwarded to the Data Entry Section of Information Systems.

RESPONSE: This recommendation was implemented with the July 13 payment cycle.

RECOMMENDATION #3: Accounts Payable establish an appropriate scheme of control over the Vendor Master File beyond the current access restriction by password.

RESPONSE: The Senior Accountant who supervises Accounts Payable will review and approve the reports showing Vendor Master records before and after changes, and will reconcile the total number of Vendor Master records in the files. That reconciliation will be reviewed by the Accounting Supervisor of the General Ledger Section, who will sign the reconciliation to evidence his review. This procedure was implemented with the July 13 payment cycle.

RECOMMENDATION #4: Someone other than any person who maintains the Vendor Master File should compare the payee on the signed check to the name on the payment authorization document and also compare the address. This task should preferably be done by someone wholly outside the Accounts Payable Section.

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RESPONSE: Both the employee who maintains the Vendor Master File and her back-up will be prohibited from participating in the distribution of checks. In addition, all of the Accounts Payable staff have been instructed to check the vendor payee name and address on the check to the payment authorization document prior to distribution. Staffing restrictions make the assignment of this function to a section outside of Accounts Payable impractical.

RECOMMENDATION #5: Finance Department management use the GADW20 "Audit Check of Vendors in File" to control the manual review of payees per the payment authorizations to the payees on the signed checks. The report can also be used to monitor the frequency and cause of any discrepancies in payee names.

RESPONSE: The GADW20 report is a listing of payee names from the disbursement and from the Vendor Master File. Currently the criteria under which this report is run are inadequate for its use as a management review document. Accounts Payable will work with Information Systems to revise the report to an exception-reporting basis, and will review it each time checks are run.

RECOMMENDATION #6: Absent the satisfactory implementation of recommendations #3, #4, and #5, the Finance Department should review endorsements on cancelled checks during the bank reconciliation process.

RESPONSE: Finance-Accounting intends to implement recommendations #3, #4, and #5. Adequate staff to undertake such a review of between 3500 and 4000 checks per month does not currently exist in Accounting, nor does Finance believe that such a review promises the additional controls that would justify such staffing.

RECOMMENDATION #7: The General Ledger Section spot check some source documents for approvals, agreement to the computer reports, and agreement to an actual check. These tasks should be completed before the payment authorization documents, computer reports, and signed checks are released for distribution. The Accounts Payable Section should also review the computer reports from the Checkwriter.

RESPONSE: Effective immediately, the Senior Account Clerk on the General Ledger transactions desk will undertake the recommended spot checks, reviewing approximately one percent (1%) of the payment documents, reports, and checks.

RECOMMENDATION #8: The Finance Director's office reconcile its check use log to the log of check stock removed from the locked storage area to determine that all the stock removed has been used for authorized purposes. This reconciliation should be made at least weekly.

RESPONSE: The two logs will be reconciled weekly by the Executive Secretary to the Director of Finance, who maintains the check use log.

RECOMMENDATION #9: The Director of Finance should designate someone other than the preparer of the check use log to periodically review reconciliations of the check use log to the check stock log. The reviewer should evidence his or her review by initialing and dating the reconciliations.

RESPONSE: Another employee in the Director's Office will be assigned to review the reconciliation of the check stock log in the General Ledger Section of Accounting to the check use log maintained by the Executive Secretary, and to evidence his or her review by signing the reconciliation.

RECOMMENDATION #11: Finance Department should either discontinue the practice of giving signed checks to the Accounts Payable Section and the requesting department, or institute additional controls to mitigate the risks that are inherent in the practice.

RESPONSE: As the Auditor discusses in his report, this issue has been extremely troublesome for Accounting. We agree wholeheartedly in theory with the Auditor that stronger internal controls exist where the distribution of checks could be separated from their preparation. Unfortunately, as is evidenced by the memorandums from Accounting to the Auditor in Appendix B, the staffing in Finance is not sufficient to accommodate this procedure: Payroll staff are especially pressed for time on Fridays, alternately with timecards and with answering questions about paychecks; Treasury staff are not sufficient to take over the distribution; and General Ledger staff control other functions of control that would make it inappropriate for them to distribute checks, even if there were sufficient staff to allow this change. In addition, checks requiring special handling are often misdirected when they are distributed by staff who do not have a high level of commitment to the accuracy of what they perceive as another section's work product.

In order to institute additional controls to mitigate the risks involved in this procedure, Accounting has implemented the following:

- As mentioned in Recommendation #4, the Accounts Payable Supervisor has revised the work flow in the unit so as to prohibit the two employees responsible for maintaining the Vendor Master File from participating in the check distribution process.
- As has been the practice in the past, no checks may be requested or approved by Accounts Payable personnel.
- General Ledger will be performing spot checks on payment documents, computer reports, and checks when they are received from Information Systems. (See Recommendation #7)

These factors, along with the additional internal controls to be implemented in the other recommendations of this report should ensure that the risk inherent in the current check distribution process is minimized.

Secondly, Accounting also agrees with the recommendation to discontinue the practice of providing checks directly to departments. It would ease the Accounts Payable Section's workload considerably if they did not have to pull checks out of the distribution for pick-up, or contact the departments involved to let them know that a check is ready. Unfortunately, we discussed this change internally and with key departments, and have come to the conclusion that it would not be practical to implement. "Special handling" on checks is a practice that often occurs because of special commitments to vendors, as well as a legitimate desire or need to make deadlines that could not be met by mailing checks.

RECOMMENDATION #12: Finance Department finalize and issue desk instructions on accounts payable functions for the General Ledger Section and the Finance Director's support staff. In addition, the desk instructions for the Accounts Payable Section should be amended to incorporate the recommendations in this report.

RESPONSE: Documentation of the accounts payable-related procedures for the Director's Office and the General Ledger control desk have been assigned to the Senior Management Staff Analyst in the Reporting Section of Accounting. That staff person is already involved with documenting the procedures for special assessment and maintenance assessment districts, with Redevelopment Agency payroll and fiscal procedures, procedures for time-reporting in the event of an earthquake or other emergency, as well as assisting with the preparation of financial statements and the year-end close of the deferred compensation accounts. However, it is anticipated that these procedures can be completed by January, 1988. The changes to the Accounts Payable desk procedures will be incorporated by October, 1987.

RECOMMENDATION #13: Finance Department require that the second signer on large checks review for appropriateness the date perforated into the supporting payment authorization documents, and evidence this review by writing that date and their initials next to the perforated date.

RESPONSE: This recommendation will be implemented immediately.

RECOMMENDATION #15: An Accounting Division supervisory employee not within the Accounts Payable Section review the production and mailing of 1099's and the handling of vendor inquiries or 1099's returned as undeliverable by the Post Office.

RESPONSE: The Supervising Accountant of the Special Accounting Division will be assigned this responsibility.

RECOMMENDATION #16: Finance Department make a thorough review of all the current requirements for filing 1099 annual information returns for vendor payments.

RESPONSE: This recommendation will be implemented immediately.

RECOMMENDATION #17: Finance Department document the Accounts Payable System completely, and then review that documentation for controls and efficiency.

RESPONSE: Accounting has done extensive work on documenting the accounts payable system, as a result both of a prior audit in this area, as well as as part of the General Accounting System evaluation. The flow charts developed by the City Auditor, which have been reviewed for accuracy by the Accounts Payable staff, provide an excellent overview of the system, augmented by the desk procedures developed for all the Accounts Payable Section staff, the addition of payment document procedures for the Finance Administrative Manual, and the critical review of the system functions done for the GAS review.

Reviewing the documentation for controls and efficiency will occur as a natural part of implementing an entirely new accounts payable system as a result of the Financial Management System project.

RECOMMENDATION #18: Accounts Payable Section should log vendor invoices received and forwarded to departments for processing. Accounts Payable should follow-up on the timely return of such invoices for payment.

RESPONSE: Implementation of this recommendation would require the addition of at least one additional clerical staff member to the Accounts Payable section. Therefore Finance does not plan to implement the recommendation at this time.

RECOMMENDATION #19: Finance Department assign someone to monitor the balances of the labor error suspense accounts and follow-up with the organizations from which those charges originated.

RESPONSE: The Payroll Section of Accounting currently sends a report out each pay period to departments, showing by employee name the balances in the error suspense account. Departments are requested to review this report, note any corrections, and return it to Payroll for adjustment. In addition, each month ISD sends a report of all activity for the year in the suspense accounts, including any corrections that have been made. This report, if returned with indicated corrections by the department, requires an adjustment voucher to by prepared by the General Ledger Section of Accounting. Effective with the July, 1987 closing, General Ledger will attach a form letter to the report sent to the departments emphasizing the importance of timely review and correction of these suspense accounts.

EGSchilling

Edward G. Schilling
Director of Finance

EH:jm
1368F/0107F-87

CITY OF SAN JOSE—MEMORANDUM

TO	Gerald A. Silva, City Auditor	**FROM**	James R. Daniels
SUBJECT	RESPONSE TO RECOMMENDATION #14 IN CONTROLS REVIEW OF THE CITY'S CHECKWRITER SYSTEM	**DATE**	July 23, 1987
APPROVED		**DATE**	

The General Services Department agrees with this recommendation. It has been implemented via the attached memorandum dated July 20, 1987.

James R Daniel

JAMES R. DANIELS
Director of General Services

jl(7459G)
cc: Ed Schilling
Sam Gaetz

RECEIVED
JUL 27 1987
CITY AUDITOR

7-01

CITY OF SAN JOSE—MEMORANDUM

TO Department Fiscal Units

FROM Sam Gaetz

SUBJECT PROCESSING CHANGE FOR CONFIRMING PURCHASE ORDERS (CPO'S)

DATE July 20, 1987

APPROVED

DATE

In order to comply with an audit recommendation regarding disbursement of the Confirming Purchase Order form, the following changes are effective immediately:

- After typing CPO, forward Accounting Division Copy (yellow) to Finance/Accounting.
- Pull Department File Copy (green) and retain.
- Submit ALL remaining copies (including the original) to Purchasing for processing.

Your cooperation in complying with this procedural change is appreciated.

Samuel E Gaetz

SAMUEL E. GAETZ
Materials and Services Manager

SEG:gb

cc: Chuck Christenson ✓
Cliff Apana

RECEIVED
JUL 22 1987
CITY AUDITOR

CITY OF SAN JOSE - MEMORANDUM

TO: Gerald Silva, City Auditor
FROM: Tim Wei
SUBJECT: RESPONSES TO CHECKWRITER AUDIT
DATE: July 21, 1987

APPROVED DATE 7-24-87

Information Systems has studied the Controls Review of the City's Checkwriter System, and would like to offer the following responses to the recommendations included in that report.

Recommendation #2: Information Systems use the accumulated dollar value of the accounts payable input file as well as the record count as a means of controlling the accuracy of the file of checks to be printed.

Response: We concur with the objectives of this recommendation and would like to work with the Finance Department and the Auditor's office to define the implementation details.

Recommendation #10: Information Systems only undertake modifications to the accounts payable computer processes after obtaining written approval from the Accounts Payable Section head. Also, Information Systems should provide training to the current Accounts Payable Section staff regarding the features and operation of all computer systems related to Accounts Payable.

Response: The policy in Information Systems is not to do any system modifications unless there is at least a verbal request from the user. A written request (Request for Service) is prepared at the time the verbal request is received.

Exceptions are made to prevent production problems from occurring or recurring. Even in these cases, no modifications should be made without notifying the user.

Information Systems and Finance have agreed to document all such verbal agreements prior to systems modification.

T. Wei
TIM WEI
Director of Information Systems

TW:AGA:ja
(1044I)

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JUL 28 1987
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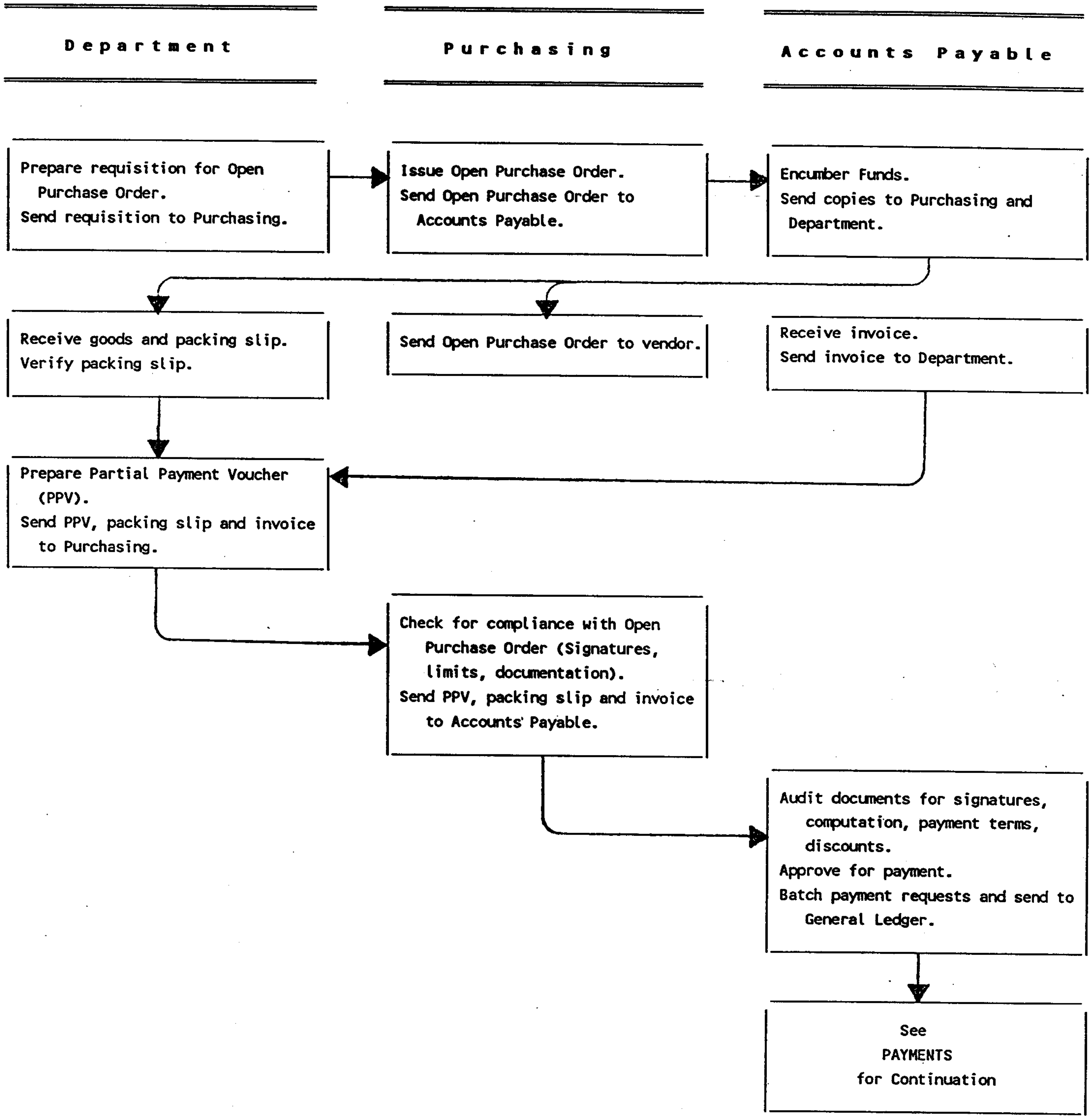
OPEN PURCHASE ORDERS
DOCUMENT FLOW



Prepare requisition for Open Purchase Order.
Send requisition to Purchasing.

Issue Open Purchase Order.
Send Open Purchase Order to Accounts Payable.

Encumber Funds.
Send copies to Purchasing and Department.

Receive goods and packing slip.
Verify packing slip.

Send Open Purchase Order to vendor.

Receive invoice.
Send invoice to Department.

Prepare Partial Payment Voucher (PPV).
Send PPV, packing slip and invoice to Purchasing.

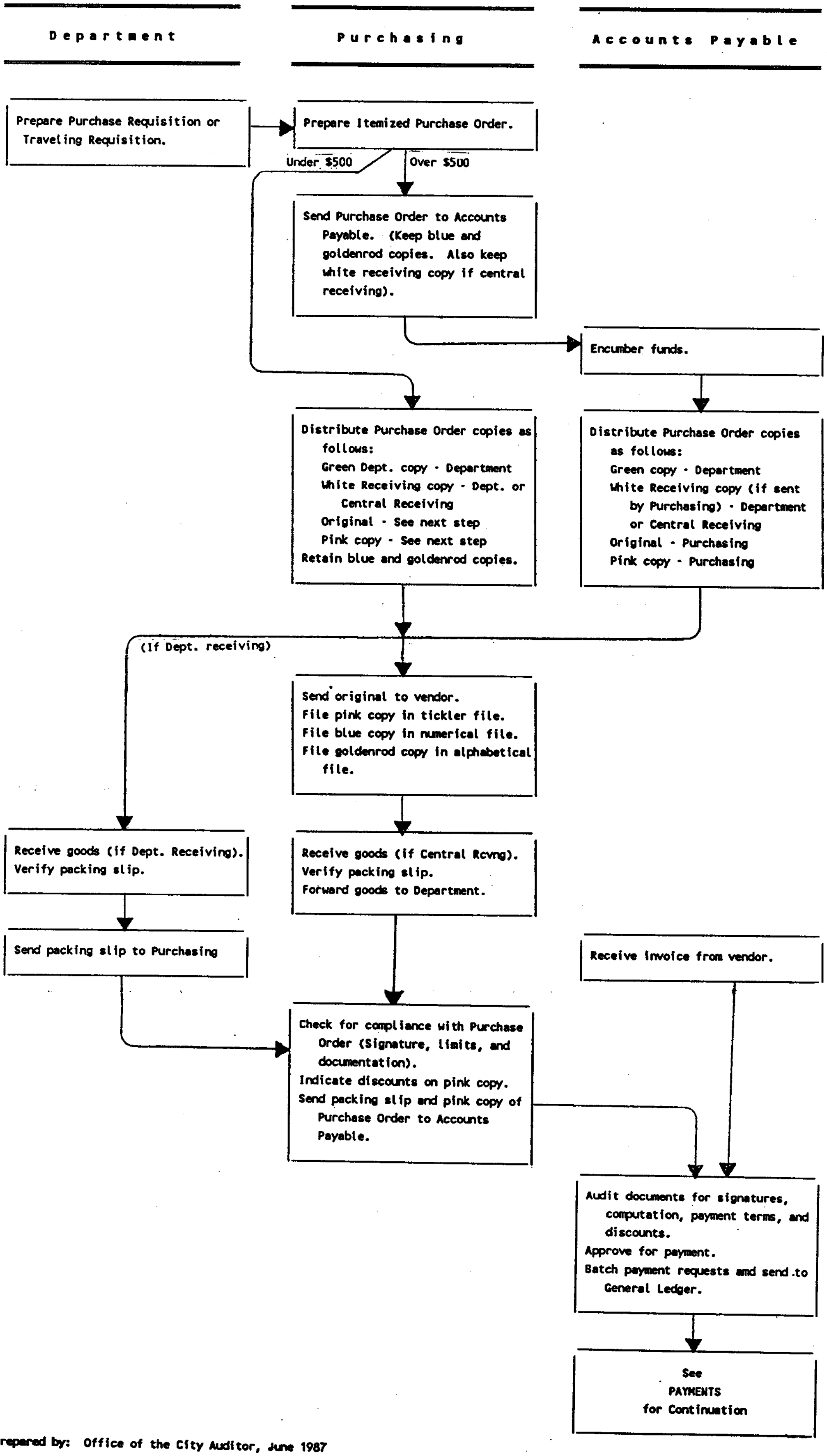
Check for compliance with Open Purchase Order (Signatures, limits, documentation).
Send PPV, packing slip and invoice to Accounts' Payable.

Audit documents for signatures, computation, payment terms, discounts.
Approve for payment.
Batch payment requests and send to General Ledger.

See
PAYMENTS
for Continuation

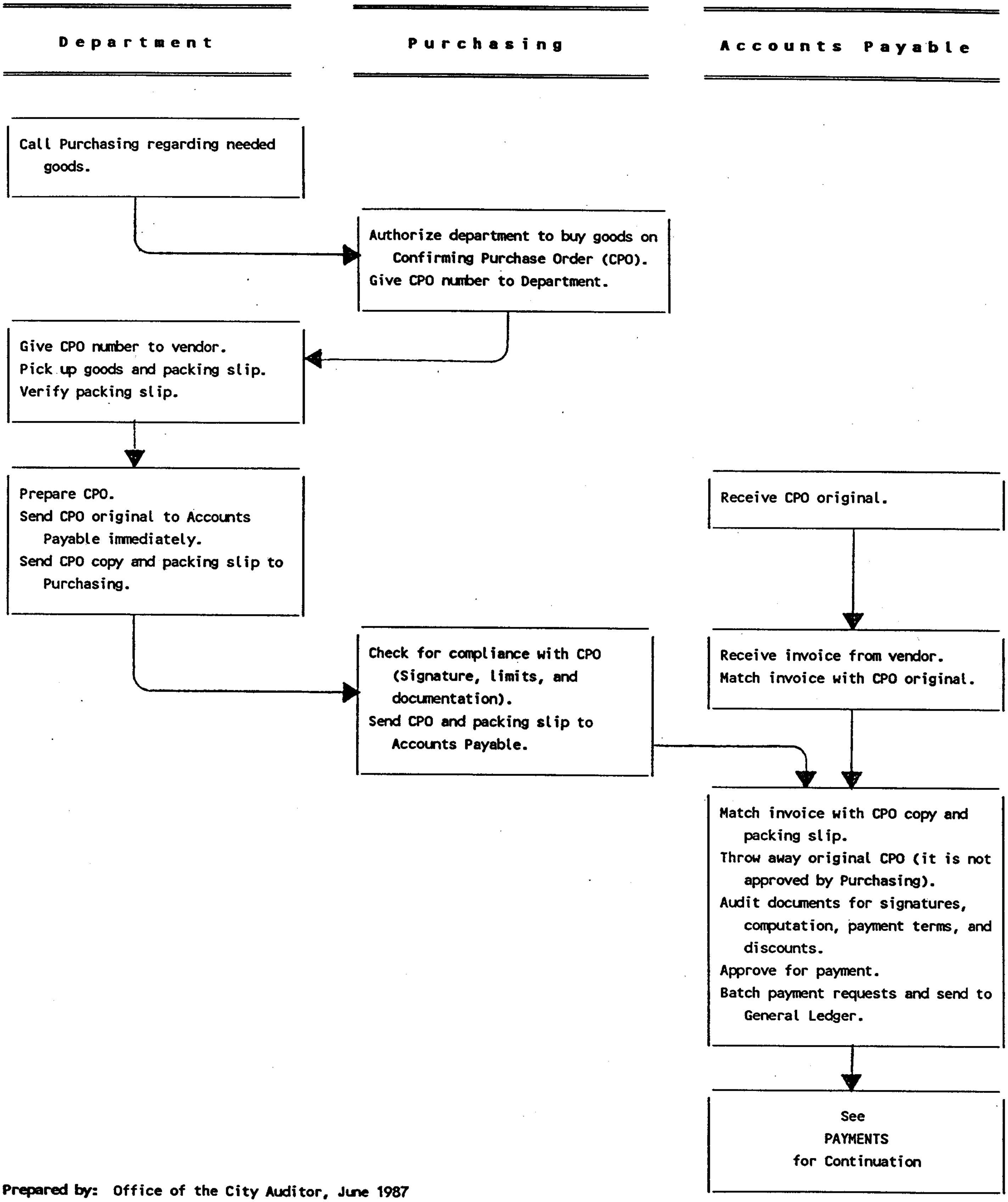
Prepared by: Office of the City Auditor, June 1987
Source: Accounting and Purchasing Staffs

ITEMIZED PURCHASE ORDERS
DOCUMENT FLOW


Department
Purchasing
Accounts Payable
Prepare Purchase Requisition or Traveling Requisition.
Prepare Itemized Purchase Order.
Under $500
Over $500
Send Purchase Order to Accounts Payable. (Keep blue and goldenrod copies. Also keep white receiving copy if central receiving).
Encumber funds.
Distribute Purchase Order copies as follows: Green Dept. copy - Department White Receiving copy - Dept. or Central Receiving Original - See next step Pink copy - See next step Retain blue and goldenrod copies.
Distribute Purchase Order copies as follows: Green copy - Department White Receiving copy (if sent by Purchasing) - Department or Central Receiving Original - Purchasing Pink copy - Purchasing
(if Dept. receiving)
Send original to vendor. File pink copy in tickler file. File blue copy in numerical file. File goldenrod copy in alphabetical file.
Receive goods (if Dept. Receiving). Verify packing slip.
Receive goods (if Central Rcvng). Verify packing slip. Forward goods to Department.
Send packing slip to Purchasing
Receive invoice from vendor.
Check for compliance with Purchase Order (Signature, limits, and documentation). Indicate discounts on pink copy. Send packing slip and pink copy of Purchase Order to Accounts Payable.
Audit documents for signatures, computation, payment terms, and discounts. Approve for payment. Batch payment requests and send to General Ledger.
See PAYMENTS for Continuation

Prepared by: Office of the City Auditor, June 1987
Source: Accounting and Purchasing Staffs

CONFIRMING PURCHASE ORDERS
DOCUMENT FLOW



Call Purchasing regarding needed goods.

Authorize department to buy goods on Confirming Purchase Order (CPO).
Give CPO number to Department.

Give CPO number to vendor.
Pick up goods and packing slip.
Verify packing slip.

Prepare CPO.
Send CPO original to Accounts Payable immediately.
Send CPO copy and packing slip to Purchasing.

Receive CPO original.

Check for compliance with CPO (Signature, limits, and documentation).
Send CPO and packing slip to Accounts Payable.

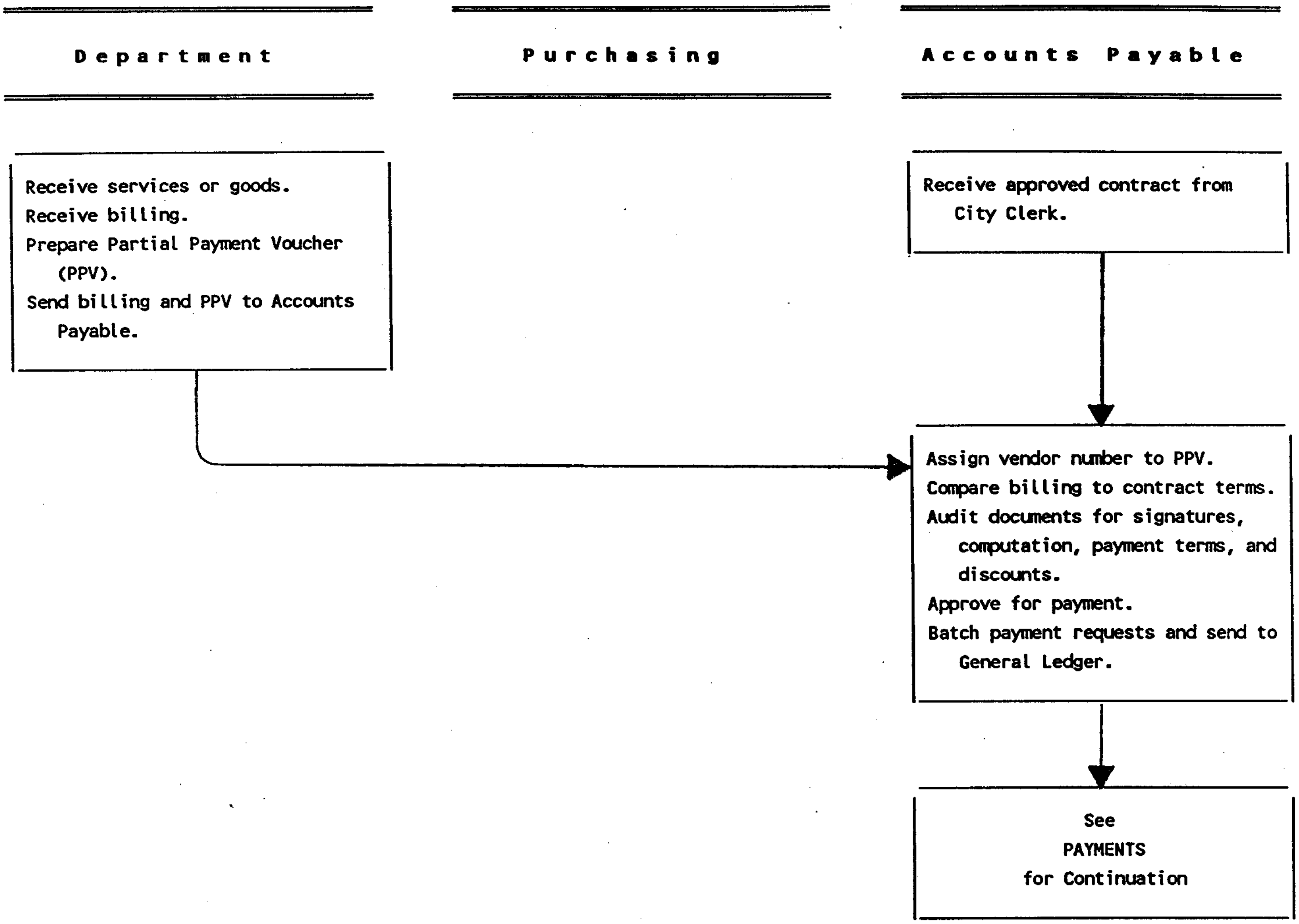
Receive invoice from vendor.
Match invoice with CPO original.

Match invoice with CPO copy and packing slip.
Throw away original CPO (it is not approved by Purchasing).
Audit documents for signatures, computation, payment terms, and discounts.
Approve for payment.
Batch payment requests and send to General Ledger.

See
PAYMENTS
for Continuation

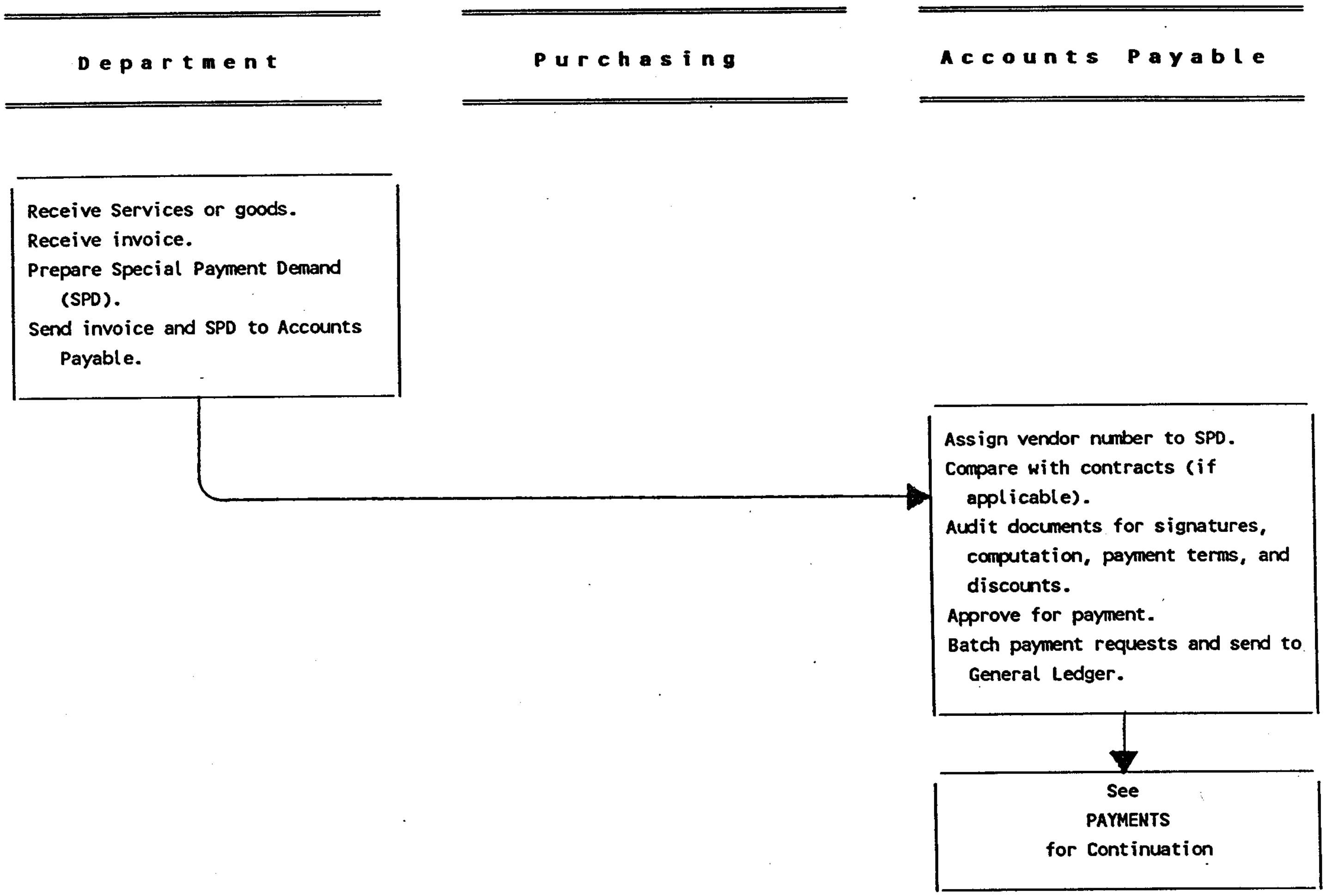
Prepared by: Office of the City Auditor, June 1987
Source: Accounting and Purchasing Staffs

CONTRACTS
DOCUMENT FLOW


Department
Purchasing
Accounts Payable
Receive services or goods.
Receive billing.
Prepare Partial Payment Voucher (PPV).
Send billing and PPV to Accounts Payable.
Receive approved contract from City Clerk.
Assign vendor number to PPV.
Compare billing to contract terms.
Audit documents for signatures, computation, payment terms, and discounts.
Approve for payment.
Batch payment requests and send to General Ledger.
See PAYMENTS for Continuation

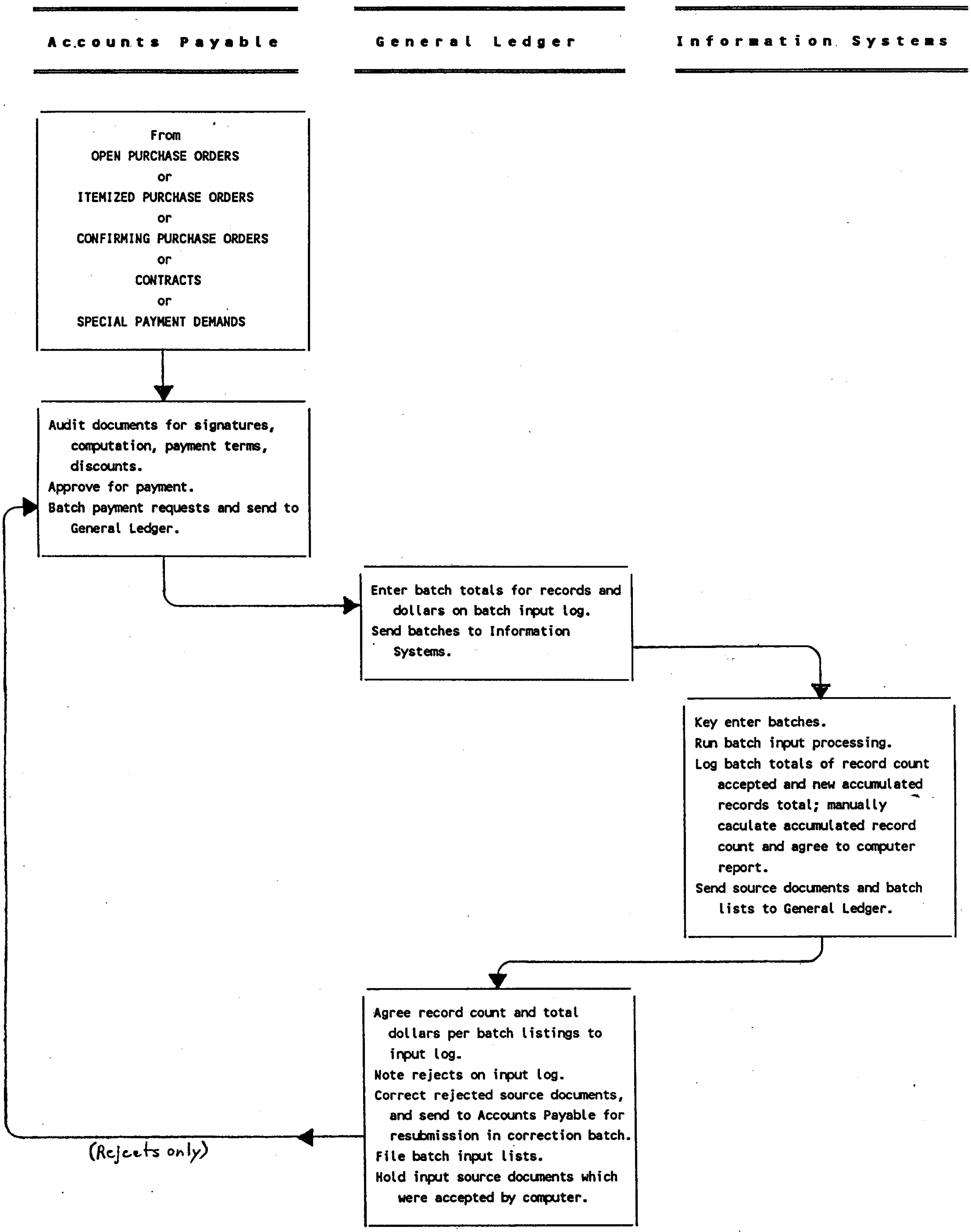
Prepared by: Office of the City Auditor, June 1987
Source: Accounting and Purchasing Staffs

SPECIAL PAYMENT DEMANDS
DOCUMENT FLOW


Department
Purchasing
Accounts Payable
Receive Services or goods.
Receive invoice.
Prepare Special Payment Demand (SPD).
Send invoice and SPD to Accounts Payable.
Assign vendor number to SPD.
Compare with contracts (if applicable).
Audit documents for signatures, computation, payment terms, and discounts.
Approve for payment.
Batch payment requests and send to General Ledger.
See
PAYMENTS
for Continuation

Prepared by: Office of the City Auditor, June 1987
Source: Accounting and Purchasing Staffs

PAYMENTS
DOCUMENT FLOW



From
OPEN PURCHASE ORDERS
or
ITEMIZED PURCHASE ORDERS
or
CONFIRMING PURCHASE ORDERS
or
CONTRACTS
or
SPECIAL PAYMENT DEMANDS

Audit documents for signatures, computation, payment terms, discounts.
Approve for payment.
Batch payment requests and send to General Ledger.

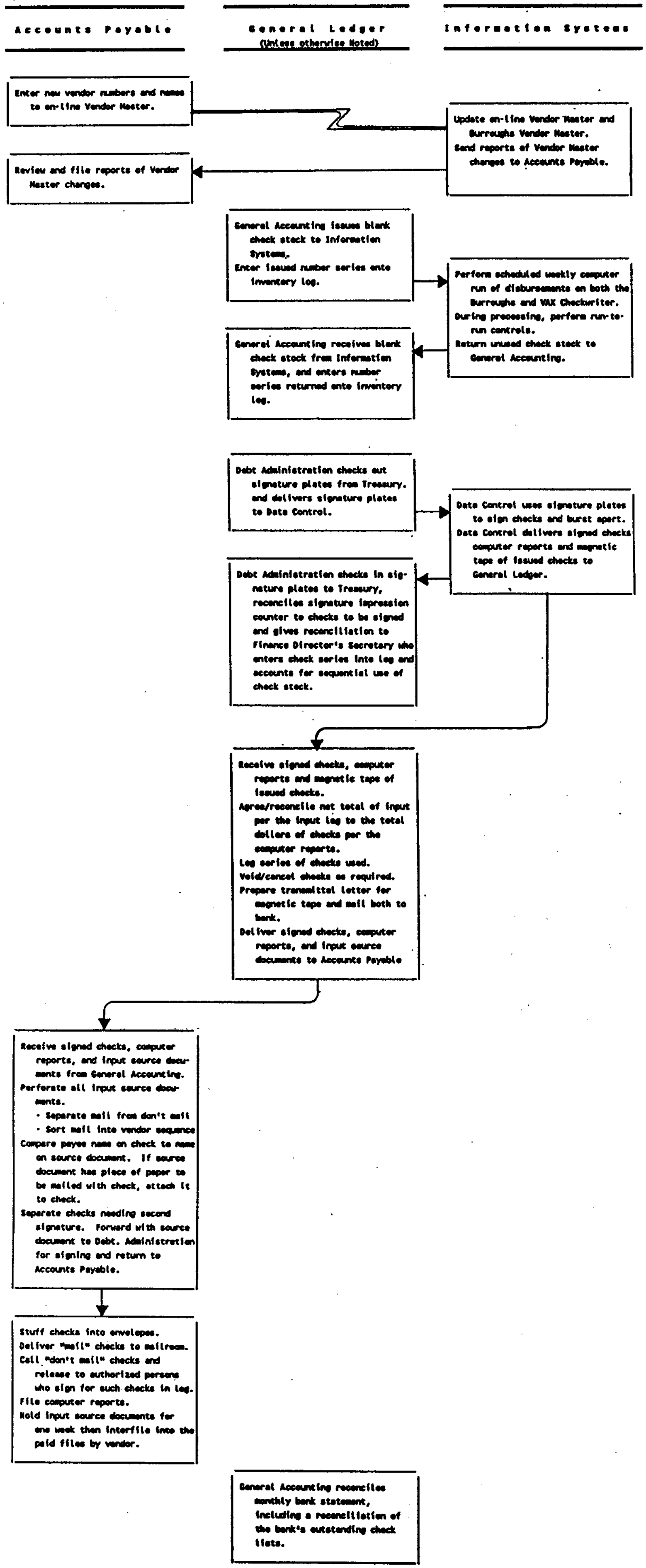
Enter batch totals for records and dollars on batch input log.
Send batches to Information Systems.

Key enter batches.
Run batch input processing.
Log batch totals of record count accepted and new accumulated records total; manually caculate accumulated record count and agree to computer report.
Send source documents and batch lists to General Ledger.

Agree record count and total dollars per batch listings to input log.
Note rejects on input log.
Correct rejected source documents, and send to Accounts Payable for resubmission in correction batch.
File batch input lists.
Hold input source documents which were accepted by computer.

Prepared by: Office of the City Auditor, June 1987
Source: Accounting and Information Systems Staffs

PAYMENTS
DOCUMENT FLOW



Accounts Payable

General Ledger
(Unless otherwise Noted)

Information Systems

Enter new vendor numbers and names to on-line Vendor Master.

Update on-line Vendor Master and Burroughs Vender Master.
Send reports of Vendor Master changes to Accounts Payable.

Review and file reports of Vendor Master changes.

General Accounting issues blank check stock to Information Systems.
Enter issued number series onto inventory log.

Perform scheduled weekly computer run of disbursements on both the Burroughs and VAX Checkwriter.
During processing, perform run-to-run controls.
Return unused check stock to General Accounting.

General Accounting receives blank check stock from Information Systems, and enters number series returned onto inventory log.

Debt Administration checks out signature plates from Treasury. and delivers signature plates to Data Control.

Data Control uses signature plates to sign checks and burst apart.
Data Control delivers signed checks computer reports and magnetic tape of issued checks to General Ledger.

Debt Administration checks in signature plates to Treasury, reconciles signature impression counter to checks to be signed and gives reconciliation to Finance Director's Secretary who enters check series into log and accounts for sequential use of check stock.

Receive signed checks, computer reports and magnetic tape of issued checks.
Agree/reconcile net total of input per the input log to the total dollars of checks per the computer reports.
Log series of checks used.
Void/cancel checks as required.
Prepare transmittal letter for magnetic tape and mail both to bank.
Deliver signed checks, computer reports, and input source documents to Accounts Payable

Receive signed checks, computer reports, and input source documents from General Accounting.
Perforate all input source documents.
- Separate mail from don't mail
- Sort mail into vendor sequence

Compare payee name on check to name on source document. If source document has piece of paper to be mailed with check, attach it to check.
Separate checks needing second signature. Forward with source document to Debt. Administration for signing and return to Accounts Payable.

Stuff checks into envelopes.
Deliver "mail" checks to mailroom.
Call "don't mail" checks and release to authorized persons who sign for such checks in log.
File computer reports.
Hold input source documents for one week then interfile into the paid files by vendor.

General Accounting reconciles monthly bank statement, including a reconciliation of the bank's outstanding check lists.

Prepared by: Office of the City Auditor, June 1987
Source: Accounting and Information Systems Staffs

RECEIVED
SEP 12 1985
CITY AUDITOR

CITY OF SAN JOSE - MEMORANDUM

TO: Gerald A. Silva
City Auditor
SUBJECT: Distribution of Checks

FROM: Emily Harrison
Chief of Accounting
DATE: September 11, 1985

APPROVED

DATE

X 5260

This memo is to confirm our agreement at our meeting on September 4, 1985 regarding the procedures relating to distribution of payroll, and accounts payable vendor checks. Several points were brought out which were key to that discussion:

1. The current procedure, suggested by Price Waterhouse & Co. several years ago and implemented subsequent to the City's investment loss without thorough review, requires that vendor checks be distributed by Payroll personnel and payroll checks by Accounts Payable personnel. Problems have arisen with the procedure due to the inadequacy of staffing and time in those sections, and due to special handling requirements of certain vendor checks.

2. A review of internal controls within the Payroll section shows that adequate safeguards exist against fraudulent payment and that internal audit review is regular and thorough.

3. A review of internal controls within the Accounts Payable section shows that:
   - No checks are requested or approved by Accounts Payable personnel.
   - After checks are run in ISD, they are delivered to, reviewed by, and balanced to register reports by another division of Accounting (General Ledger).
   - Finance Department signature authority for approving check requests on the City's general account is limited to the Finance Director, Chief of Treasury, and the Financial Analysis Supervisor.

4. In the case of special checks, the requests are given to General Ledger, and their personnel do all typing, protecting and signature approval.

5. The Cashiering Section of Treasury, staffed by two people and located on the second floor, could not accommodate the distribution task, although this would be an optimum method of insuring internal control.

For all these reasons, it was agreed that the procedure for check distribution will be changed to allow each Accounting unit to handle their own check distribution. This procedure will be implemented in October, in order to allow time for training staff new to the Accounts Payable section.

Jerry, thank you again for your help, as well as for Darla and Jack's in reviewing this procedure.

E. Harrison
Emily Harrison
Chief of Accounting

Attachments

cc: Ed Schilling
Cliff Apana
Mel Eisenach
Thayne Waldron
Walter Spruck

EH:jm
4885F:0259F

APPENDIX B

CITY OF SAN JOSE - MEMORANDUM

TO: Gerald Silva
City Auditor

FROM: Emily Harrison
Chief of Accounting

SUBJECT: Distribution of Checks

DATE: August 16, 1985

APPROVED

DATE

As I mentioned on the phone, we are currently reviewing our internal control procedures in regards to distribution of checks by the Accounts Payable and Payroll sections. Currently Accounts Payable receives from the control desk (General Ledger Section) and distributes all payroll checks, and Payroll provides the same service for Accounts Payable. Our concerns with this procedure are several: Payroll staffing is short, and is especially pressed for time during the week timecards are coming in, so that check distribution may be delayed; Accounts Payable checks which require special handling have been misdirected; the controls of disbursement approval and review already in place make this inefficient and time-consuming procedure unnecessary.

I would appreciate any assistance you could provide in our review.

Emily Harrison
Chief of Accounting

EH:maw
4801F:0258F

APPENDIX B

CITY OF SAN JOSE - MEMORANDUM

TO Thayne L. Waldron
Acting Chief of Accounting
SUBJECT Distribution of Vendor and Payroll Checks

FROM Cliff Apana
Senior Accountant
DATE May 29, 1985

APPROVED

DATE

In 1983, the Accounting Firm of Price Waterhouse & Co. recommended that the distribution of vendor and payroll checks be reassigned, i.e., vendor checks will be distributed by the Payroll Sections and payroll checks will be distributed by the Accounts Payable Section.

Ostensibly, this was done to assure that the accounting principle of separation of duties relative to internal control be maintained.

The majority of payment documents for both types of checks are not initiated by either section. Furthermore, payroll and some vendor checks are distributed by each section within a department and would require an elaborate system of net working and collaboration for any type of collusion or fraud to be done.

Vendor checks that require mailing would also involve many parties to participate in any fraudulent activity and subsequently would be unsuccessful.

For the reasons stated above and for the increased efficiency and accuracy that would result from reassignment, it is recommended that the responsibilities for distribution of vendor checks and payroll checks be given back to the respective sections.

Your approval for this recommendation is requested.

Cliff Apana
Cliff Apana
Senior Accountant

CA:maw

4506F:240F